

Request for Permission to Proceed with Formal Regulation Process on Renumbering  
Regulation Section 25136 as Regulation Section 25136(a) and to Adopt New Regulation  
Section 25136(b)

The California statutory scheme for the sales factor of the apportionment formula has undergone two major changes during the last two years. First, the Legislature replaced the currently operative rules for sales of other than tangible property that were contained in California Revenue and Taxation Code section 25136 with a new set of rules that were to become operative on January 1, 2011. Then, in the most recent budget trailer bill (SB 858), the Legislature brought back the old rules and made them applicable to a certain group of taxpayers, while retaining the “new” rules for other taxpayers.

The statutory scheme now provides under California Revenue and Taxation Code section 25136(a) that, for taxable years beginning before January 1, 2011 and for taxable years beginning on or after January 1, 2011 for which an election under Revenue and Taxation Code section 25128.5(a) has not been made, sales other than sales of tangible personal property are assigned based on where the income-producing activity is performed. The existing California Code of Regulations, title 18, section 25136, is operative for taxable years beginning before January 1, 2011, was last amended in July 2010, and will remain applicable to the income-producing activity provisions of California Revenue and Taxation section 25136(a). This existing regulation will be renumbered as "Regulation Section 25136(a)".

California Revenue and Taxation Code section 25136(b) is operative for all members of an affiliated group that has made the election to use the single sales factor apportionment formula for taxable years beginning on or after January 1, 2011. The rules contained in California Revenue and Taxation Code section 25136(b) generally provide that sales of other than tangible personal property are assigned to the numerator of the sales factor based upon the location where the benefit of the services was received or the location of the use of the intangibles. The Franchise Tax Board was granted the authority to issue regulations to carry out the purpose of these new provisions. The proposed regulation for the new market based rules will be numbered as "Regulation Section 25136(b)".

To obtain public input on possible language for this new regulation, staff has conducted three interested parties meetings. The first meeting took place on February 10, 2010. At that meeting staff presented information on how other states are assigning sales under rules similar to those in the new law, but did not present specific language for a regulation. Staff went back to the interested parties again on July 19, 2010. At that time, staff presented a draft regulation and solicited input from the interested parties. After the July meeting, staff, taking the input received, amended the regulation substantially and then held another interested parties meeting on November 8, 2010. After the November meeting additional clarifications were made to the new regulation to reflect the input of interested parties.

Staff requests permission to enter into the formal regulatory process to adopt the regulatory amendments to renumber the existing regulation as Regulation Section 25136(a) and to adopt a new regulation as Regulation Section 25136(b).

## Explanation of Proposed Regulation Section 25136(b)

California Revenue and Taxation Code section 25136(b) is operative for all members of an affiliated group that has made the election to use the single sales factor apportionment formula for taxable years beginning on or after January 1, 2011. The rules contained in California Revenue and Taxation Code section 25136(b) generally provide that sales of other than tangible personal property are assigned to the numerator of the sales factor based upon the location where the benefit of the services was received or the location of the use of the intangibles. The Franchise Tax Board was granted the authority to issue regulations to carry out the purpose of these new provisions. The proposed regulation for the new market based rules will be named "Regulation Section 25136(b)".

The proposed regulation is generally divided into four parts: a definitional section, a section that addresses the rules for services, a section that address the rules for intangibles, and miscellaneous provisions that include special rules, rules for rental of real property and tangible personal property and other issues.

### **1. General Definition Section.**

"Benefit of a service is received." The definition of this term is the location where the taxpayer's customer has either directly or indirectly received value from delivery of that service. Examples have been provided under the definition.

"Service." This term is defined as "a commodity of activities engaged in by a person for another person for consideration." It does not include activities performed by someone who is not a regular trade or business offering services to the public nor does it include services rendered to another member of the taxpayer's combined reporting group.

"Cannot be determined." This term has been defined to mean that a taxpayer's records or the records of the taxpayer's customer do not indicate either where the benefit of a service is received or the location of the use of the intangible. However, the provision regarding the Franchise Tax Board accepting a reasonable approximation where, for instance, the necessary data of a smaller corporation cannot be reasonably developed from the financial records maintained in the regular course of business, has been moved to Special Rules under (g)(1).

"Commercial domicile." This is defined as the principal place from which the trade or business of the taxpayer is directed or managed.

"Intangible property." This term is extensively defined, and includes definitions for a "marketing intangible", a "non-marketing and manufacturing intangible," and "mixed intangibles." These three terms are used for the assignment of intangible property where intangible property is licensed.

"Intangible personal property is used." This term means the location where the intangible property is employed by the taxpayer's customer or licensee.

"Reasonably approximated." This term means when all available information (contract or taxpayer's business records) does not indicate the location of the market for the benefit of the services or the location of the use of the intangible property, then the location may be reasonably approximated in a manner consistent with the business of the customer. Public information, such as population, can be a reasonable approximation, but information that is specific in nature is preferred over information that is general in nature.

"To the extent." This term means that if the customer that receives the benefit of the service or uses the intangible property in more than one state, the gross receipts from the performance of the service or the sale of intangible property will be included in the sales factor numerator according to the portion of the benefit of the services that are received or the use of the intangible property is in this state.

## **2. Application.**

### **Benefit of the Service Section.-Subsection (c)**

This provision is divided into two sections: one that applies to individuals and one that applies to corporations or other business entities.

In the provision applicable to sales to individuals, subsection(c)(1), the first cascading rule provides that the individual's billing address is presumed to be the location where the benefit of a service is received. The second cascading rule provides that the billing address presumption may be overcome by the taxpayer<sup>1</sup> with reference to the terms of the contract between the taxpayer and the taxpayer's customer, or the taxpayer's business records as kept in the normal course of business, in order to determine the location where the benefit is received. If none of the above indicates the location where the benefit of the service is received, then the location of where the benefit is received may be reasonably approximated. Examples are given to show how the cascading rules work.

In the section that applies to corporations and other business entities, subsection (c)(2), the first cascading rule has a presumption that the benefit of the service took place where the benefit of the service was received, as indicated by the taxpayer's contract with their customers, or through the taxpayer's business records. This is different than for individuals because it is believed that for business entities, there is a high probability that the benefit of the service is received in more than one place, and that the billing address may therefore be less accurate than the contract or the books and records of the taxpayer. This presumption may be overcome by both the Franchise Tax Board or the taxpayer. The second cascading rule provides that if the benefit of the services received cannot be determined by the taxpayer's contracts with its customers, or the taxpayer's books and records, or the presumption in the first cascading rule is overcome, then the location of where the benefit of the service was received will be reasonably approximated. If the benefit of the service received cannot be determined under either the first two cascading rules, then the third

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<sup>1</sup> As the result of comments by business representatives at the third Interested Parties Meeting, the proposed regulation language was changed so that only the taxpayer may rebut the presumption. In essence this creates a safe harbor for taxpayers who assign their receipts pursuant to billing address. If the taxpayer attempts to rebut the presumption and use a method other than the billing address, then this effort may be audited.

cascading rule presumes that the benefit of the service received is from the location from where the taxpayer's customer placed the order for the service. The fourth cascading rule provides that if none of the first three cascading rules are applicable, then the benefit of the service received shall be in California if the taxpayer's billing address is located in California. Again, there are examples showing how the cascading rules work.

#### **Use of Intangible Property Section.-Subsection (d)**

There are two types of sales for intangible property: sales that completely transfer all rights in the intangible property from the seller to the buyer; and sales that arise from the use, licensing, lease, or rental of intangible property which do not divest the seller of its ownership rights.

For sales that completely transfer all rights to the intangible property from the seller to the buyer, the first cascading rule, subsection (d)(1), states that the sale will be assigned to the location where the purchaser of the intangible property will use it at the time of sale of the intangible property. This first cascading rule provides a presumption that the contract between the taxpayer and the purchaser of the intangible property or the taxpayer's business records determines the location of the use of the intangible property at the time of the purchase. This presumption may be overcome by either the taxpayer or the Franchise Tax Board. The second cascading rule provides that if the location of the use of the intangible property cannot be determined under the first cascading rule, or the presumption in the first cascading rule has been overcome, the sale may be reasonably approximated by reference to the activities of the purchaser, as limited by the jurisdiction or jurisdictions to which the transfer applies. If this is not possible, then there is a third cascading rule that provides that the sales are assigned to the customer's billing address if neither of the first two cascading rules apply. Examples are given to show how the cascading rules work.

Subsection (d)(2) addresses sales arising from the use, licensing, lease or rental of intangible property. The approach set forth in this subsection is that there are three types of these transactions: transactions involving marketing intangibles, transactions involving non-marketing and manufacturing intangibles, and transactions involving mixed intangibles<sup>2</sup>. This approach was based on Massachusetts' rules involving the assignment of receipts from intangibles.

For marketing intangibles, their value lies predominantly in the marketing of the intangible property in connection with goods, services or other items sold by the taxpayer's customer. . For instance, in the case of a license to place a cartoon character's image on a towel, the use of the intangible by the towel seller relates to its value in marketing the towel for sale. The image of the character makes the towel more marketable and increases its value in the market place over a plain towel. Therefore, these types of license fees are assigned according to ultimate customer sales in this state of the marketed product that contains the intangible. Under the first cascading rule, the contract between the taxpayer and licensee or the taxpayer's business records is presumed to determine this state's customers for those goods. If the presumption is overcome, then the next cascading rule provides determination

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<sup>2</sup> These terms are all defined in subsection (b)(5) of the regulation.

of this state's customers is to be reasonably approximated and this may be done by using population data of the geographic region of where the licensee markets its goods.

After receiving input from taxpayers that they may be unable to determine the ultimate location because they are licensing to a wholesaler who manufactures the product and sells through many different retailers unknown to the taxpayer, the regulation was amended to include a wholesale rule, found in subsection (d)(2)(A)3. This rule provides that if the license of a marketing intangible is at wholesale rather than at retail, then the sales may be assigned by the taxpayer by reference to population data for the area covered by the licensing arrangement with the wholesaler.

For non-marketing and manufacturing intangibles, the customer's use of the intangible lies predominately in using the intangible in a manufacturing process. Therefore, these sales are assigned according to use in this state. Under the first cascading rule, the contract between the taxpayer and licensee or the taxpayer's business records is presumed to indicate the location of the use of the intangible. If that presumption is overcome by either the Franchise Tax Board or the taxpayer, then under the second cascading rule the location of the use is to be reasonably approximated. If neither of the first two cascading rules can provide where the taxpayer's customer is using these intangibles, then the third cascading rule provides that the sale is assigned to the licensee's billing address.

Where the intangible is mixed (marketing and non-marketing/manufacturing) and the fees are separately stated in the licensing contract, then the Franchise Tax Board will accept the separately stated amounts for assignment of the sale if reasonable. If the Franchise Tax Board determines that the separate statement is not reasonable, then the Franchise Tax Board may assign the sales under a reasonable method that reflects the licensing of a marketing intangible and a non-marketing or manufacturing intangible. Where the fees are not separately stated, then it is presumed that the fees are paid for a marketing intangible, except to the extent the taxpayer or the FTB can reasonably establish otherwise.

There are examples for all three scenarios above.

**Sales from the sale, lease, rental or licensing of real property – subsection (e) – and sales from the rental, lease or licensing of tangible personal property – subsection (f)**

The former provisions and example in existing Regulation section 25136, relating to sales from the sale, lease, rental, or licensing of real property, and sales from the rental, lease, or licensing of tangible personal property, have been included.

**Special Rules Section.**

There is a special rule allowing for the use of approximations by taking into consideration the effort and expense to obtain information.

There is a special rule that provides that in determining a reasonable approximation for the location of use involving marketing intangibles under subsection (d)(2)(A) 2, the taxpayer can determine their customer's or licensee's use of intangible property in this state by

looking to various factors, including the number of licensed sites in each state, the volume of property manufactured, produced or sold pursuant to the arrangement at locations in this state, or other data, including population, that reflects the relative usage of the intangible property in this state.

There is a special rule that requires a taxpayer's method of reasonably approximating the location of the benefit of the services or the use of the intangible property must be used consistently by the taxpayer for subsequent years. A change may not be made without the permission of the Franchise Tax Board.

Special rules have been provided for Regulation sections 25137 through 25137-14 where those provisions were incorporated by reference with changes. For taxable years beginning on or after January 1, 2011, all references to RTC section and CCR section are to the new statute and regulation operative January 1, 2011. Those sections that generally reference RTC section and/or CCR section 25136 are 25137, 25137-1 [Partnerships], 25137-2 [Contractors], 25137-4.2 [Banks and Financials], 25137-8 [Motion Picture], 25137-10 [Generals and Financials], 25137-11 [Trucking], 25137-12 [Print Media], 25137-14 [Mutual Funds].

In addition, the following sections with specific language regarding income-producing activity, costs of performance or throwback provisions have been modified: CCR 25137(c)(1)(C) [Special Rules. Sales Factor], CCR section 25137-3's [Franchisors], CCR section 25137-4.2 [Banks and Financials] and CCR section 25137-12 [Print Media].

## 25136 (2011) Proposed Language

§ 25136(b). Sales Factor. Sales Other than Sales of Tangible Personal Property in this State.

(a) In General. Sales other than those described under Revenue and Taxation Code Section 25136 are in this state if the taxpayer's market for the sales is in this state.

(b) General Definitions.

(1) "Benefit of a service is received" means the location where the taxpayer's customer has either directly or indirectly received value from delivery of that service.

Examples:

- (A) Real Estate Development Corp with its commercial domicile in State A is developing a tract of land in this state. Real Estate Development Corp contracts with Surveying Corp from State B to survey the tract of land in this state. Regardless of where the survey work is conducted, where the plats are drawn, or where the plats are delivered, the recipient of the service, Real Estate Development Corp, received all of the benefit of the service in this state.
- (B) Builder Corp with its commercial domicile in State A is building an office complex in this state. Builder Corp contracts with Engineering Corp from State B to oversee construction of the buildings on the site. Engineering Corp performs some of its service in this state at the building site and additional service in State B. Because all of Engineering Corp's services were related to a construction project in this state, the recipient of the services, Builder Corp, received all of the benefit of the service in this state.
- (C) General Corp with its commercial domicile in State A contracts with Computer Software Corp from State B to develop and install custom computer software for General Corp. The software will be used by General Corp in a business office in this state and in a business office in State A. The software development occurs in State B. The recipient of the service, General Corp, received the benefit of the service in both State A and in this state.
- (D) Apartment Corp owns 100 apartments in this state and 400 apartments in State A, and contracts with Pest Control Corp for pest control services for all the apartments. The benefit of the service is received in both State A and in this state.

(2) "Service" means a commodity consisting of activities engaged in by a person for

another person for consideration. The term "service" does not include activities performed by a person who is not in a regular trade or business offering its services to the public, and does not include services rendered to another member of the taxpayer's combined reporting group as defined in Regulation section 25106.5(b)(3).

- (3) "Cannot be determined" means that the taxpayer's records or the records of the taxpayer's customer which are available to the taxpayer do not indicate the location where the benefit of the service was received or where the intangible property was used.
- (4) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.
- (5) "Intangible property" includes, but is not limited to, patents, copyrights, trademarks, service marks, trade names, licenses, plans, specifications, blueprints, processes, techniques, formulas, designs, layouts, patterns, drawings, manuals, trade secrets, stock, contract rights including broadcasting rights, and other similar intangible assets.
  - (A) A "marketing intangible" includes, but is not limited to, the license of a copyright, service mark, trademark, or trade name where the value lies predominantly in the marketing of the intangible property in connection with goods, services or other items.
  - (B) A "non-marketing and manufacturing intangible" includes, but is not limited to, the license of a patent, a copyright, or trade secrets to be used in a manufacturing process, where the value of the intangible lies predominately in its use in such process.
  - (C) A "mixed intangible" is the license of intangible property that includes both a license of a marketing intangible and a license of a non-marketing intangible.
- (6) "Intangible personal property is used" means the location where the intangible property is employed by the taxpayer's customer or licensee.
- (7) "Reasonably approximated" means that, considering all sources of information other than the terms of the contract and the taxpayer's books and records kept in the normal course of business, the location of the market for the benefit of the services or the location of the use of the intangible property is determined in a manner that is consistent with the business of the customer. Information, including publicly available information such as population, that is specific in nature, is preferred over information that is general in nature.

- (8) "To the extent" means that if the customer of a service receives the benefit of a service or uses intangible property in more than one state, the gross receipts from the performance of the service or the sale of intangible property are included in the numerator of the sales factor according to the portion of the benefit of the services received and/or the use of the intangible property in this state.
- (c) Sales from services are assigned to this state to the extent the customer of the taxpayer receives the benefit of the service in this state.
- (1) In the case where an individual is the taxpayer's customer, the benefit of the service shall be presumed to be received at the billing address of the taxpayer's customer, as determined at the end of the taxable year. If the taxpayer uses the customer's billing address as the method of assigning the sales to this state, the Franchise Tax Board will accept this assignment.
- (A) This presumption may be overcome by the taxpayer by showing, by a preponderance of the evidence, that either the contract between the taxpayer and the taxpayer's customer, or other books and records of the taxpayer kept in the normal course of business, provide the extent to which the service is performed at a location (or locations) in this state. If the taxpayer believes it has overcome the presumption and uses an alternative method based on either the contract between the taxpayer and the taxpayer's customer or other books and records of the taxpayer kept in the normal course of business, the Franchise Tax Board may examine the taxpayer's alternative method to determine if the billing address presumption has been overcome and, if so, whether the taxpayer's method of assignment reasonably reflects where the benefit of the service was received by the taxpayer's customers.
- (B) If the presumption in (c)(1) is overcome by the taxpayer, yet no alternative method can be derived by reference to the books and records of the taxpayer kept in the normal course of business, or the contract between the taxpayer and its customer, then the location where the benefit of the services is received by the customer shall be reasonably approximated.
- (C) Examples.
1. Phone Corp provides telecommunications services to individuals in this state and other states for a monthly fee billed to the customer's address. Gross receipts from these services are assigned to this state if the billing address of the customer is in this state.
  2. Travel Support Corp located in this state provides travel information services to its customers, who are individuals located throughout the United States, through a call center located in this state. The contract

between Travel Support Corp and its customers provides that for a fee per call, the customer can call Travel Support Corp for information regarding hotels, restaurants and other travel related information.

Travel Support Corp's records indicate that fifteen percent of its customers have billing addresses in this state. However, Travel Support Corp's books and records, maintained in the regular course of business, indicate that only seven (7) percent of the calls handled by the call center originate from this state. Because Travel Support Corp's books and records show where the benefit of the services is actually received, the billing address presumption is overcome and the books and records of the taxpayer may be used to assign seven (7) percent of the gross receipts from the support services provided by the call center to this state.

3. Same facts as Example 2 except the contract between Travel Support Corp and its customers provides for a set monthly fee, regardless of whether the customer actually calls for travel support. The fact that only seven (7) percent of the calls originate from this state does not overcome the presumption that the benefit of the services is received at the billing address.
- (2) In the case where a corporation or other business entity is the taxpayer's customer, the benefit of the service shall be presumed to be received at the location (or locations) indicated by the contract between the taxpayer and the taxpayer's customer or the taxpayer's books and records, notwithstanding the billing address of the taxpayer's customer.
- (A) To the extent that the contract between the taxpayer and the taxpayer's customer or the taxpayer's books and records (notwithstanding the billing address of the taxpayer's customer) kept in the normal course of business provide the location (or locations) where the benefit of the services is received, such location (or locations) will be presumed to be where the benefit of the services is actually received. This presumption may be overcome by the taxpayer or the Franchise Tax Board upon an evidentiary showing, by a preponderance of the evidence, that the location (or locations) indicated by the contract or the taxpayer's books and records was not the actual location where the benefit of the service was received.
  - (B) If neither the contract nor the taxpayer's books and records provide the location where the benefit of the service is received, or the presumption in subparagraph (A) is overcome, then the location (or locations) where the benefit is received shall be reasonably approximated.
  - (C) If the location where the benefit of the service is received cannot be determined under subparagraph (A) or reasonably approximated under

subparagraph (B), then the location where the benefit of the service is received shall be presumed to be the location from which the taxpayer's customer placed the order for the service.

- (D) If the location where the benefit of the service is received cannot be determined pursuant to subparagraphs (A), (B), or (C), then the benefit of the service shall be in this state if the taxpayer's customer's billing address is in this state.

(E) Examples.

1. Payroll Services Corp contracts with Customer Corp to provide all payroll services. Customer Corp is commercially domiciled in this state and has employees in a number of other states. The contract between Payroll Services Corp and Customer Corp does not specify where the service will be used by Customer Corp. Payroll Services Corp's books and records indicate the number of employees of Customer Corp in each state where Customer Corp conducts its business. Payroll Services Corp shall assign its receipts from its contract with Customer Corp by determining the ratio of employees of Customer Corp in this state compared to all employees of Customer Corp and assign that percentage of the receipts from Customer Corp to this state.
2. Law Corp located in State C has a Client Corp that has manufacturing plants in this state and State B. Law Corp handles a major litigation matter for Client Corp concerning a manufacturing plant owned by its client in this state. All gross receipts from Law Corp's services related to the litigation are attributable to this state because Law Corp's books and records kept in the normal course of business indicate that the services relate to Client Corp's operations in this state.
3. Audit Corp is located in this state and provides accounting, attest, consulting, and tax services for Client Corp. The contract between Audit Corp and Client Corp provides that Audit Corp is to audit Client Corp for taxable year ended 20XX. Client Corp's books and records kept in the normal course of business, as well as its internal controls and assets, are located in States A, B and this state. As a result, Audit Corp's staff will perform the audit activities in States A, B and this state. Audit Corp's business books and records track hours worked by location where its employees performed their service. Audit Corp's receipts are attributable to this state and States A and B according to the taxpayer's books and records which indicate time spent in each state by each staff member.
4. Web Corp provides internet content to its viewers and receives revenue from providing advertising services to other businesses. Web Corp's

contracts with other businesses do not indicate the location (or locations) where the benefit of the service is received. The advertisements are shown via the website to Web Corp viewers and the fee collected is determined by reference to the number of times the advertisement is viewed and/or clicked on by viewers of the website.

- a. If Web Corp, through its books and records kept in the normal course of business, can determine the location from which the advertisement is viewed and/or clicked on by viewers of the website, then gross receipts from the advertising will be assigned to this state by a ratio of the number of viewings and/or clicks of the advertisement in this state to the total number of viewings and/or clicks on the advertisement.
- b. If Web Corp cannot determine the location from which the advertisement is viewed and/or clicked on through its books and records, it shall reasonably approximate the location of the receipt of the benefit by assigning its gross receipts from advertising by a ratio of the number of its viewers in this state to the number of its subscribers everywhere.

5. For a flat fee, Painting Corp contracts with Western Corp to paint Western Corp's various sized buildings located in this state and four (4) other states. The contract does not break down the cost of the painting per building or per state. Painting Corp's books and records kept in the normal course of business indicate the location of the buildings that are to be painted but do not provide any method for determining the extent that the benefit of the service is received in this state, i.e. the size or number of buildings to be painted at each location.

- a. Since neither the contract nor Painting Corp's books and records indicate how much of the fee is attributable to this state and there is no method of reasonably approximating the location of where the benefit of the service is received, the sale will be assigned to this state if the order for the service was placed from this state.
- b. If the sale cannot be assigned under subparagraph a., then the sale shall be assigned to this state if Western Corp's billing address is in this state.

(d) Sales from intangible property are assigned to this state to the extent the property is used in this state.

- (1) In the case of the complete transfer of all property rights in intangible property as defined in subsection (b)(5) for a jurisdiction or jurisdictions, the use of intangible property in this state shall be determined as follows:
- (A) The contract between the taxpayer and the purchaser, or the taxpayer's books and records kept in the normal course of business, shall be presumed to provide where the purchaser will use the intangible at the time of purchase. This may include records providing the extent that the intangible property is used in this state by the taxpayer prior to the time of the sale of the intangible property. This presumption may be overcome by the taxpayer or the Franchise Tax Board by a preponderance of the evidence showing that the purchaser's use of the intangible at the time of purchase is not consistent with the terms of the contract or the taxpayer's books and records.
  - (B) If the extent of the use of the intangible property in this state cannot be determined under subparagraph (A) or the presumption under subparagraph (A) is overcome, the location where the intangible property is used shall be reasonably approximated by reference to the activities of the purchaser, limited to the jurisdictions where the purchaser, at the time of purchase, will use the intangible, to the extent such information is available to the taxpayer. If population is a reasonable approximation, the population used shall be the U.S. population, unless it can be shown by the taxpayer that the intangible is being used materially in other parts of the world. If this is shown then only the populations of those other countries where the intangible is being materially used shall be added to the U.S. population.
  - (C) If the extent of the use of the intangible property in this state cannot be determined pursuant to subparagraphs (A) or (B), then the gross receipts shall be assigned to the billing address of the purchaser.
  - (D) Examples.
    - 1. Parent Corp sells all of the stock of Subsidiary Corp. Subsidiary Corp, at the time of sale, had locations in this state and three (3) other states. Taxpayer's books and records indicate Subsidiary Corp had payroll and property in this state of 15% and 25%, respectively. In assigning the receipt from the sale of Subsidiary Corp, Taxpayer may average the property and payroll percentages and assign 20% of the receipt from the sale to this state.
    - 2. Taxpayer sells a patent to Buyer Corp that will be used by Buyer Corp to manufacture products for sale in the United States. The contract between Taxpayer and Buyer Corp indicates that Buyer Corp will have the exclusive rights to the patent for exploitation in the United States. At the time of the purchase, Taxpayer knows that Buyer Corp has three

factories that will use the patented process in manufacturing, one of which is located in this state. In the absence of specific information as to the amount of manufacturing Buyer Corp does at each of the three locations, Taxpayer assigns the receipts from the sale equally among the three states where Buyer Corp has manufacturing plants, assigning 33% of the sale to this state.

3. Same as Example (2), but Taxpayer has no information regarding Buyer Corp's activities. Taxpayer may assign the receipt to the billing address of Buyer Corp.
- (2) In the case of the licensing, leasing, rental or other use of intangible property as defined in subsection (b)(5), not including sales of intangible property provided for in paragraph (1), the use of intangible property in this state shall be determined as follows:
- (A) Marketing intangibles.
1. Where a license is granted for the right to use intangible property in connection with the sale, lease, license, or other marketing of goods, services, or other items, the royalties or other licensing fees paid by the licensee for such right(s) are presumed to be attributable to this state to the extent that the fees are attributable to the sale or other provision of goods, services, or other items purchased or otherwise acquired by this state's customers, as is provided for by the terms of the contract between the taxpayer and the licensee of the intangible property or the taxpayer's books and records kept in the normal course of business. If the contract or the taxpayer's books and records provide a method for determination of this state's customers for the purchase of goods, services, or other items in connection with the use of the intangible property, then the contract's terms or the taxpayer's books and records shall be used to determine this state's customers for the purchase of goods, services, or other items in connection with the use of the intangible property.
  2. If the location of the use of the intangible property is not determinable under subparagraph 1, the location of the use of the intangible property shall be reasonably approximated by reference to the activities of the taxpayer's customer to the extent such information is available to the taxpayer. Reasonable approximation of the location of the use of the intangible property includes, but is not limited to, the percentage of this state's population as compared with the total population of the geographic area in which the licensee uses the intangible property to market its goods, services or other items, to the extent such information is available to the taxpayer.

3. Where the license of a marketing intangible is for the right to use the intangible property in connection with sales or other transfers at wholesale rather than directly to retail customers, the taxpayer may be unable to develop information regarding the location of the ultimate use of the intangible property. If this is the case, then the taxpayer may attribute the receipt to this state based solely upon the percentage of this state's population as compared with the total population of the geographic area in which the licensee uses the intangible property to market its goods, services or other items. Only the populations of those countries where the intangible is being materially used shall be taken into account.

(B) Non-marketing and manufacturing intangibles.

1. Where a license is granted for the right to use intangible property other than in connection with the sale, lease, license, or other marketing of goods, services, or other items, the licensing fees paid by the licensee for such right(s) are attributable to this state to the extent that the use for which the fees are paid takes place in this state, as is provided for by the terms of the contract between the taxpayer and the licensee of the intangible property or the taxpayer's books and records kept in the normal course of business. If the contract or the taxpayer's books and records provide a method for determination of the extent of the use of the intangible property in this state, then the contract's terms or the taxpayer's books and records will be presumed to properly indicate the extent of the use of the intangible property in this state. This presumption may be overcome by the taxpayer or the Franchise Tax Board.
2. If the location of the use of the intangible property for which the fees are paid cannot be determined under subparagraph 1 or the presumption in subparagraph 1 is overcome, then the location of the use of the intangible property shall be reasonably approximated by reference to the activities of the taxpayer's customer, to the extent such information is available to the taxpayer.
3. If the location of the use of the intangible property for which the fees are paid cannot be determined under subparagraphs 1 or 2, it shall be presumed that the use of the intangible property takes place in the state of the licensee's billing address.

(C) Mixed Intangibles.

1. Where the fees to be paid in each instance are separately stated in the licensing contract, the Franchise Tax Board will accept such separate statement for purposes of this section if it is reasonable. If the

Franchise Tax Board determines that the separate statement is not reasonable, then the Franchise Tax Board may assign the fees using a reasonable method that accurately reflects the licensing of a marketing intangible and the licensing of a non-marketing intangible.

2. Where a license of intangible property includes both a license of a marketing intangible and a license of a non-marketing intangible and the fees to be paid in each instance are not separately stated in the contract, it shall be presumed that the licensing fees are paid entirely for the license of the marketing intangible, except to the extent that the taxpayer or the Franchise Tax Board can reasonably establish otherwise.

(D) Examples.

1. **Marketing Intangible.** Crayon Corp and Dealer Corp enter into a license agreement whereby Dealer Corp as licensee is permitted to use trademarks that are owned by Crayon Corp in connection with Dealer Corp's sale of certain products to retail customers. Under the contract, Dealer Corp is required to pay Crayon Corp a licensing fee that is a fixed percentage of the total volume of monthly sales made by Dealer Corp of products using the Crayon Corp trademarks. Under the agreement, Dealer Corp is permitted to sell the products at multiple store locations, including store locations that are both within and without this state. The licensing fees that are paid by Dealer Corp are broken out on a per-store basis. The licensing fees paid to Crayon Corp by Dealer Corp represent fees from the licensing of a marketing intangible and the fees that are derived from the individual sales at stores in this state constitute sales in this state.
2. **Marketing Intangible.** Moniker Corp enters into a license agreement with Whole Corp where Whole Corp is granted the right to use trademarks owned by Moniker Corp to brand sports equipment that is to be manufactured by Whole Corp or an unrelated entity, and to sell the manufactured product to unrelated companies that make retail sales in a specified geographic region. Although the trademarks in question will be affixed to the tangible property to be manufactured, the license agreement confers a license of a marketing intangible. The component of the licensing fee that constitutes sales of Moniker Corp in this state is determined by multiplying the amount of the fee by the percentage of this state's population over the total population in the specified geographic region in which the retail sales are made.
3. **Non-marketing Intangible.** Formula Corp and Appliance Corp enter into a license agreement whereby Appliance Corp is permitted to use a patent owned by Formula Corp to manufacture and sell appliances at

stores owned by Appliance Corp within a certain geographic region. The license agreement specifies that Appliance Corp is to pay Formula Corp a royalty equal to a fixed percentage of the gross receipts from the products sold. The contract does not specify any other fees. The appliances are manufactured and sold in this state and several other states. Given these facts, it is presumed that the licensing fees are paid for the license of a manufacturing intangible. Since Formula Corp can demonstrate the percentage of manufacturing by Appliance Corp that takes place in this state using the patent, that percentage of the total licensing fee paid to Formula Corp under the contract will constitute Formula Corp's sales in this state.

4. Mixed Intangible. Axel Corp enters into a two-year license agreement with Biker Corp in which Biker Corp is granted the right to produce motor scooters using patented technology owned by Axel Corp, and also to sell such scooters by marketing the fact that the scooters were manufactured using the special technology. The scooters are manufactured outside this state, but the taxpayer is granted the right to sell the scooters in a geographic area in which this state's population constitutes 25% of the total population in the geographic area during the period in question. The licensing agreement requires an upfront licensing fee to be paid by Biker Corp to Axel Corp but does not specify which percentage of the fee is derived from Biker Corp's right to use Axel Corp's patented technology. Unless either the taxpayer or the Franchise Tax Board reasonably establishes otherwise, it is presumed that the licensing fees are paid entirely for the license of a marketing intangible. In such cases, it will be presumed that 25% of the licensing fee constitutes sales in this state.
5. Mixed Intangible. Same facts as Example 4, except that the license agreement specifies separate fees to be paid for the right to produce the motor scooters and for the right to sell the scooters by marketing the fact that the scooters were manufactured using the special technology. The licensing agreement constitutes both the license of a marketing intangible and the license of a non-marketing intangible. Assuming that the separately stated fees are reasonable, the Franchise Tax Board will: (1) attribute no part of the licensing fee paid for the non-marketing intangible to this state, and (2) attribute 25% of the licensing fee paid for the marketing intangible to this state.

- (e) Sales from the sale, lease, rental, or licensing of real property are in this state if and to the extent the real property is located in this state.
- (f) Sales from the rental, lease, or licensing of tangible personal property are in this state if and to the extent the tangible personal property is located in this state.

Example: Railroad Corp is the owner of 10 railroad cars. During the year, the total of the days each railroad car was present in this state was 50 days. The receipts attributable to the use of each of the railroad cars in this state are a separate item of income and shall be determined as follows:

$$\frac{(10 \times 50 =) 500 \times \text{Total Receipts}}{(365 \times 10 =) 3650} = \text{Receipts Attributable to This State}$$

(g) Special Rules.

- (1) In assigning sales to the sales factor numerator pursuant to Revenue and Taxation Code section 25136, the Franchise Tax Board shall consider the effort and expense required to obtain the necessary information, as well as the resources of the taxpayer seeking to obtain this information, and may accept a reasonable approximation when appropriate, such as when the necessary data of a smaller business cannot be reasonably developed from financial records maintained in the regular course of business.
  - (A) Example. Small Corp, a corporation located in this state, provides limited bookkeeping services to clients both within and outside this state. Some clients have several operations among various states. For the past ten (10) years, Small Corp's only records for the sales of these services have consisted of invoices with the billing address for the client. Small Corp's records have been consistently maintained in this manner. If the FTB determines that Small Corp cannot determine, pursuant to financial records maintained in the regular course of its business, the location where the benefit of the services it performs are received under the rules in this regulation, then Small Corp's sales of services will be assigned to this state using the billing address information maintained by the taxpayer. Small Corp will not be required to alter its recordkeeping method for purposes of this regulation.
- (2) To determine the customer's or licensee's use of intangible property in this state under subsection (d)(2)(A)2. for marketing intangibles, factors that may be considered include the number of licensed sites in each state, the volume of property manufactured, produced or sold pursuant to the arrangement at locations in this state, or other data including population that reflects the relative usage of the intangible property in this state.
- (3) The following special rules shall apply in determining the method of reasonable approximation of the location of the market for the benefit of the services or the location of the use of the intangible property:

- (A) Once a taxpayer has used a reasonable approximation method to determine the location of the market for the benefit of the services or the location of the use of the intangible property, then the taxpayer must continue to use that method in subsequent taxable years. A change to a different method of reasonable approximation may not be made without the permission of the Franchise Tax Board.
  - (B) The method of reasonable approximation shall reasonably relate to the income of the taxpayer. For example, if the taxpayer includes in its reasonable approximation methodology countries which are identified in its contracts or its books and records maintained in the normal course of business but for which no sales are made during the taxable years at issue, then the reasonable approximation methodology being used by the taxpayer does not reasonably relate to the income of the taxpayer.
- (4) The sales factor provisions set forth in Regulation sections 25137 through 25137-14 are hereby incorporated by reference, with the following modifications for taxable years beginning on and after January 1, 2011:
- (A) All references to RTC section 25136 and CCR section 25136 shall refer to RTC section and CCR section 25136 as they are operative beginning on and after January 1, 2011.
  - (B) Regulation section 25137(c)(1)(C) [Special Rules. Sales Factor] shall not be applicable.
  - (C) The provisions in Regulation section 25137-3 [Franchisors] that relate to the taxpayer not being taxable in a state shall not be applicable.
  - (D) The provisions in Regulation section 25137-4.2 [Banks and Financials] that relate to income-producing activity and costs of performance, and throwback, shall not be applicable.
  - (E) The provisions in Regulation section 25137-12 [Print Media] that relate to a taxpayer not being taxable in another state and the sale's inclusion in the sales factor numerator if the property had been shipped from this state, shall not be applicable.

Note: Authority cited: Section 19503, Revenue and Taxation Code.  
Reference cited: Section 25136, Revenue and Taxation Code.